



OXFORD ANALYTICA

SRI LANKA

FISCAL TRANSPARENCY

Country Report 2005

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SRI LANKA



COMPLIANCE RATINGS

<i>Fiscal transparency</i>	2005	2004	2003	2002
Clarity of roles
Availability of information
Budget preparation
Accountability
Score	3.00	3.00	3.00	2.75

OUTLOOK & COMMENTARY

The 2003 Fiscal Management Responsibility Act (FMRA) has improved fiscal transparency in some areas, but has yet to be fully implemented. Of particular concern is the government's failure to meet the 5% budget deficit target by 2006; it is now expected to be at least 9% by the end of 2005. External shocks such as the tsunami and oil price rises have contributed to this situation, but so has the government's inability to increase revenues through improved collection methods.

The impact of the tsunami has diverted resources away from improving government transparency, but the recent presidential elections and the continuing uncertainties for the internal peace process have also stalled progress. Furthermore, the budget released in November 2005 has now been annulled as the newly elected president released a further budget for 2006 in December. Privatisation has also been halted and instead the government is concentrating on restructuring public enterprises into commercial ventures. The Bank of Ceylon has been successfully restructured, but work on the People's Bank is still in progress.

Progress continues towards full compliance with the IMF Special Data Dissemination Standard (SDDS). A new Inland Revenue Act has been proposed and will be presented to parliament early next year. This should simplify tax procedures and create an independent tax ombudsman.

EXECUTIVE SUMMARY

3.00 Enacted

In April 2004, a new coalition government was elected, with the main political party from the previous administration now spearheading the opposition. This signalled a turnaround from previous economic policy: the previous administration had embarked on an ambitious and wide-ranging programme of economic reform, which was progressing until last year's political crisis. These economic reforms have been stalled under the current government, which now appears to be rolling them back in favour of new policies. The recent presidential elections also strengthened the current administration.

The 2003 Fiscal Management Responsibility Act (FMRA) has improved fiscal transparency in some areas, but has yet to be fully implemented. The government does use a Medium-Term Macroeconomic Framework, and releases mid-year fiscal position reports to account for deviations from budget targets. However, there have been several violations of the Act already; for example, the release of the 2006 budget only ten days before the presidential elections and the government's failure to meet the 5% budget deficit target by 2006. The budget deficit is expected to be at least 9% by the end of 2005, and in the coming years the government is planning to increase current expenditure, financing it through increased revenues and economic growth. External shocks such as the tsunami and oil price rises have contributed to this situation, but so has the government's inability to increase revenues through improved collection methods.

Although the impact of the tsunami in December 2004 has diverted resources away from improving government transparency, the recent presidential elections and continuing uncertainty for the peace process have also stalled progress. Furthermore, the budget released in November has now been annulled as the newly elected president released a further budget for 2006 in December.

A new Inland Revenue Act is in the pipeline and will be presented to parliament early next year. This should simplify tax procedures and appoint an independent tax ombudsman. Sri Lanka subscribes to the IMF's General Data Dissemination System (GDDS), but it has yet to fully subscribe to Special Data Dissemination Standard (SDDS). The Central Bank of Sri Lanka (CBSL) is the primary collector and disseminator of detailed fiscal data for Sri Lanka, although the Ministry of Finance (MoF) has expanded its dissemination of analytical fiscal data. The CBSL has introduced a number of enhancements to statistics, including the provision of more detailed estimates and the implementation of an advance release calendar, aimed at bolstering public information flows.

Sri Lanka's overall score is unchanged from last year.

1. CLARITY OF ROLES, RESPONSIBILITIES, AND OBJECTIVES



Enacted

The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.

Structure, functions, and responsibilities of government

The legal basis for government in Sri Lanka is provided by the 1978 Constitution.¹ Article 27(4) establishes that the state shall strengthen and broaden the democratic structure of government and the democratic rights of the people by decentralising the administration and by affording all possible opportunities to the people to participate at every level in national life and in government.

Some of the constitution's statutory provisions were tested in 2002 when, for the first time, the prime minister and president were from opposing political parties. This uncomfortable cohabitation led to a political crisis in November 2003 when, whilst the prime minister was abroad, the president suspended parliament and took control of three ministries.² Parliament resumed following the return of the prime minister, but internal tensions continued. In April 2004, a new coalition government was elected, with the main political party from the previous administration now spearheading the opposition.

Commentators have stressed that the change in government in 2004 has signalled a turnaround from previous economic policy and the elections this autumn have also confirmed a continuation of the current leadership. The clarity of roles between government departments has become somewhat muddled; for example, the secretary to the Ministry of Finance (MoF) is widely perceived as being too involved in the running of a number of public sector agencies, such as the Central Bank of Sri Lanka (CBSL).³

Coordination and management of budgetary activities

The prime minister and the government prepared and presented two budgets in parliament during 2002 and one in November 2003, approved with a slight delay due to the political crisis. Last year, the government's fiscal year 2005 budget was also delayed and, breaking with tradition, the government appeared to limit the participation of multilateral institutions (such as the World Bank and IMF) during budget preparations. Nevertheless, broader consultation was sought from trade chambers, industry associations, business organisations and research institutions. An opportunity was also given to citizens to participate, with the government receiving over 1,000 specific proposals in response.⁴ Some commentators highlighted that the previous administration had embarked on an ambitious and wide-ranging programme of economic reform, which was progressing until the 2004 political crisis. These economic reforms have stalled under the current government, which appears to be rolling them back in favour of new policies.⁵

At present, there is still no budget committee in parliament. Whereas the previous government had been contemplating establishing one, currently there is no intention to do so. In the absence of a parliamentary budget committee, there is some concern about the purpose and value of having a budget debate in parliament.⁶

Sri Lanka has eight Provincial Councils (PCs) responsible for their own budget process and the provision of some key public services. The transparency of financial accounts of some PCs is still deemed to be poor and there is a

lack of detailed data on expenditures.⁷ The PCs continue to rely heavily on central government grants, and some ambiguities in the relationship between the two levels of government remain. Some fiscal powers have been devolved to the provinces, although the process is still incomplete; the system remains complex, with parallel systems of administration and poor accountability mechanisms. Overall, there has been no further decentralisation in the last two years. Some provinces still have very few revenue raising options.

Relations between government and public sector agencies

One of the primary tasks identified by the previous administration had been the trimming of Sri Lanka's sizeable and under-performing public sector. However, the composition of the current coalition government, which includes strong left-wing and nationalist groups, has meant that privatisation and a reduced government are no longer a policy priority. Indeed, the government appears committed not to privatise public enterprises designated as "strategic enterprises". However, there is no legal obstacle to the divestment of state assets not labelled as strategic. In agreement with the revamped public sector role, a Strategic Enterprise Management Agency (SEMA) was set up in early 2005 to shore up public enterprises and restructure them into viable commercial ventures. Currently, the largest 14 public corporations have been placed under this agency. In addition, the government stated earlier this year that in order for any of these corporations to be privatised, there has to be approval by a two-thirds majority in parliament.⁸

Legislation to set up a multi-sector regulatory authority -- the Public Utilities Commission of Sri Lanka (PUC) -- was enacted in 2003, empowering it to regulate electricity, water supply services, and petroleum product markets. In practice, the PUC remains dormant - the government has withdrawn some reforms that would transfer the supervision from line ministries to the multi-sector regulator. Although the electricity sector was scheduled to be the first sector to come under PUC regulation, the Ceylon Electricity Board has not yet been financially fragmented into several competing companies due to trade union agitation in response to the prepared draft legislation. The government has now set up a committee to review the draft law; its members include trade union representatives. A water management bill was also withdrawn, also owing to union dissatisfaction. Most members of the PUC have now resigned because of the difficult political environment.⁹

Quasi-fiscal activities of public enterprises, such as the petroleum companies and the Ceylon Electricity Board, continue. For example, electricity and petrol prices remain below cost as the government continues to subsidise them.¹⁰

Government involvement in the private sector

The distinction between government departments, non-commercial public enterprises and commercial ones is not always clear.¹¹ There is also a risk that policy and management roles within partially privatised enterprises become unnecessarily complex. Some commentators suggested that a large programme of directed lending might be implemented in the near future, as well as cross borrowings from state institutions, which could lead to large overdrafts and other fiscal risks.¹²

The planned reforms to the financial sector, particularly the broadening of government financing away from captive sources of funding -- such as the Employee Provident Fund (EPF) -- are no longer in progress. In fact, some commentators argued that the government has been tapping into the EPF for funds.¹³ There were plans to improve the management of the state-operated pension schemes -- the EPF and the Employees' Trust Fund (ETF) -- through mergers, private fund management, some foreign portfolio investments, improved collection and management reforms to reduce evasion, but there has been no progress on this over the last year.

A new Financial Services Act (FSA) is still in draft form; there has been no advance since last year. When passed, it will aim to develop a system for regulating the securities market, insurance and private provident funds; improve accounting and auditing standards; and prevent money laundering.¹⁴

The privatisation of the country's two largest state banks -- the People's Bank and the Bank of Ceylon -- was cancelled in 2004. The People's Bank has been designated as one of the twelve "strategic enterprises" that cannot be privatised. Restructuring of the Bank of Ceylon was completed this year and it now operates fairly independently from the government. Its financial viability has also improved and neither bank issues government guarantees anymore. The restructuring programme of the People's Bank is still in progress.¹⁵

There should be a clear legal and administrative framework for fiscal management

Legal framework for budgetary activities

The constitution provides the legal basis for fiscal activity in Sri Lanka. In addition, the Fiscal Management Responsibility Act (FMRA), enacted in January 2003, places ceilings on government borrowings from the CBSL, sets medium-term fiscal deficit targets, and mandates "pre-election budget reports" (before parliamentary elections) to discourage election handouts. In addition, it sets clear limits and guidelines for budgetary activities and the fiscal process. Some commentators have underscored that there is a perceived lack of commitment by the current government to attain the targets set in the FMRA.¹⁶

Section 3 of the FMRA establishes fiscal objectives, and a number of stages that the government is required to present to parliament and the public with regard to its record in the management of the economy. This report, the *Fiscal Strategy Statement*, is available on the MoF's website.¹⁷

Substantial deviations from the announced targets are required to be placed before parliament, as was the case for the changes in budget deficit limits introduced through the *Fiscal Strategy Statement 2005*. The government is also required to present before parliament an overview of the potential fiscal impact of all new policies that are to be introduced. More importantly, the FMRA also requires the imposition of limits on government guarantees.

Starting in the third quarter of 2003, any government departments which do not submit their accounts and performance reports in due time will have their funding curtailed; a provision that was strictly enforced in 2003. Commentators said enforcement was lax during 2004.¹⁸

It has also been noted that the government continues to engage in quasi-fiscal operations; using public financial corporations to subsidise the cost of financing the budget. For example, rupee securities and foreign-currency denominated bonds (often at below market rates) are placed with state-owned banks and financial corporations.¹⁹

Legal framework for taxation

There is a clear legal basis for taxation in several pieces of legislation, most notably the Inland Revenue Act (No. 38) of 2000 and the Value Added Tax Act (No. 14) of 2002. These acts are published in the *Gazette*, and are available at a small fee from the Government Publications Bureau. The Department of Inland Revenue maintains a basic website that provides summary information on the range of taxes and tax schedules in operation.

The management of Sri Lanka's tax system has been acknowledged to be increasingly difficult, with a narrowing tax base, numerous ad hoc exemptions, and multiple taxes on the same transactions. As a result, revenue-to-GDP ratios declined in recent years. In 2002, the government embarked on major tax reform aimed at streamlining taxation and, in the process, making it more transparent. Many of these reforms have been consistent with IMF

recommendations.²⁰ A Revenue Management Advisory Committee -- composed of experienced tax administrators and representatives of trade chambers -- was established in May 2002, charged with advising on the establishment of a new consolidated revenue authority, to incorporate the present Inland Revenue, Customs, and Excise Departments and the revenue-collecting arm of the Board of Investment.

Since then, the tax administration system has been simplified and the tax base widened. This year, new tax legislation was passed to improve tax collection, replacing the previously proposed Unified Revenue Authority Act. Tax collection has increased, but this has been mainly because of increased tax rates and the imposition of new taxes, rather than improved administration or enforcement. Some commentators have argued that there is still a need to further broaden the tax base.²¹ The Budget of 2006 also proposes to bring out a new Inland Revenue Act by end-March 2006, replacing the 2000 law that has now become confusing due to its large number of amendments. Included in this proposed Act is a measure to appoint a tax ombudsman or Commissioner of Inland Revenue.²²

Ethical standards for public servants

Besides the *Establishment Code*, there continues to be a lack of a single, publicly available code of ethical standards for public servants, although a new code of conduct for personnel in the inland revenue service is included in the proposed Inland Revenue Act expected to be presented to Parliament in early 2006. This is despite calls by the country's leading chamber of commerce for the government to publish a code of ethics, which would apply to the executive, legislators, and public officials requiring an effective declaration of assets by all key officials.²³ At present, there are no plans to introduce such code.

2. PUBLIC AVAILABILITY OF INFORMATION



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The public should be provided with full information on the past, current, and projected fiscal activity of government.

Central government operations

The 2003 Fiscal Management Responsibility Act (FMRA) stipulates that the Minister of Finance must furnish a statement that includes, inter alia, expenditure not outlined in the budget (although most public spending is now included in the budget), addressing the previous lack of coverage of some off-budget activities. The public has access to a wide range of timely information. The MoF and several of its internal departments maintain a website with links to a variety of information. The budget papers for fiscal year 2005 were available soon after the presentation of the budget, including hyperlinks to a variety of government websites.²⁴ However, commentators have stated that although data on revenues is timelier, there is a lack of detailed information on government expenditure, especially at the local, provincial level.²⁵

For contingent liabilities, there is only information on government guarantees, and an assessment of possible external shocks. The IMF has recommended that a more systematic method of reporting both implicit and contingent liabilities be adopted.²⁶

Within the MoF, the Fiscal Policy Department (FPD), formally the Department of Fiscal Policy and Economic Affairs, publishes a range of secondary data on past, current and projected fiscal activity. Monthly economic updates, monthly revenue bulletins and weekly price bulletins are made available online.²⁷ It also publishes an annual report on *Trends in Public Finance*, although improvements in the online distribution of this information would be welcomed, since the most recent report available online is for fiscal year 1998. In addition, Sri Lanka disseminates information on fiscal activity via the CBSL, whose *Annual Report* contains the *Summary of Government Fiscal Operations*.

Expenditure data are disaggregated according to function, including information on revenue transfers to sub-national levels (PCs), and social security expenditure. Revenue data are disaggregated by source. However, the available data does not include comprehensive information on the impact of a number of tax incentives. Commentators have underscored that the information available on government operations provides little detail on specific budget programmes/measures and line items.²⁸

As mentioned above, the FMRA requires the minister of finance to issue the *Fiscal Strategy Statement* at the time of the budget and, where necessary, at other times during the year. The statement includes the government's medium term fiscal policy, including fiscal objectives and targets for three years ahead, and explains broad strategic priorities. A noticeable shortcoming is that there is no mechanism for allowing more scrutiny or public response to the report. In this respect, civil society groups drafted a *Freedom of Information Act* in August 2003, which was expected to be presented in parliament soon after. However, due to political instability since November 2003, there appears to be no political resolve to press on with the bill's enactment.²⁹

Public sector operations

The accounts of quasi-corporations, such as the railways and postal services, are included with the government data. Other public sector enterprises publish regular reports detailing their operations. However, fiscal transparency would benefit from additional disclosure and explanation of these operations. Sri Lanka's private sector has called for greater transparency in this area, especially through web-enabled central databases, covering public sector procurements, infrastructure projects, consultancy services, privatisations, vacancy advertisements, and resource mobilisation plans.³⁰ Some public sector enterprises do not operate in line with market principles; in this respect, the labour unions in the Departments of Railways and Post have at times been disruptive in the restructuring process.

Commentators have highlighted that the reporting of public corporations is generally poor. The exceptions are mostly financial public enterprises, which have good accounting and reporting standards with respect to timeliness and accuracy. They publish proper accounts and conduct internal audits. Other public institutions, of which there are many, provide insufficient and irregular reporting. In practice, there are no accountability measures taken for the non-compliance of reporting financial statements, which creates a situation where the government disburses funds to corporations that may not have any published accounts.³¹

In 2003, all government departments and public corporations were required, for the first time in 50 years, to adhere to strict deadlines for the submission of performance reports and annual accounts to the MoF. Public enterprises that do not adhere to the above can be penalised by way of freezing their financial disbursements from the Treasury. This sanction was strictly enforced in 2003, and the timeliness -- if not necessarily the quality -- of most financial statements improved.

An Economic Management Law, drafted in 2003, was designed to oblige the government to report to parliament on the progress that has been made by each ministry in implementing economic reforms. According to this law, the budgets for respective line ministries will be directly linked to progress made in implementing reform. However, the previous government shelved this law, and there are no plans to present it again.³²

Parliament has a Committee on Public Accounts (COPA) and a Committee on Public Enterprises (COPE). These two committees are empowered to scrutinise public sector accounts including public enterprises. This year a report was published looking at the central bank. Although these committees have been more active than in previous years, some commentators said that in practice the committees have insufficient powers to be effective, they operate with limited capacity, and their proceedings are not transparent. The Chairman of the Financial Committee at COPE is now also minister of industry.³³

A commitment should be made to the timely publication of fiscal information.

Sri Lanka subscribes to the IMF's General Data Dissemination System (GDDS). Implementation of the IMF Special Data Dissemination Standard (SDDS) is still in progress. Work continues on completing the data required for subscription, but it is not known when this will be ready.³⁴ Nevertheless, commentators said that the timeliness of monthly data dissemination has significantly improved.³⁵

Debt Reporting

Sri Lanka continues to meet the requirements on debt reporting, including breakdowns by holder, instrument and currency. These data are produced with three months' timeliness, while broader aggregates are disseminated on a monthly basis.

Some concern was expressed regarding the debt levels of public corporations, and whether these appear as part of total debt figures. The IMF, as part of its advisory role, has ensured that some transfers to public corporations are registered as public debt, but the amount of these types of transactions that remain unrecorded is uncertain.³⁶

Advance release calendars

The CBSL is the primary collector and disseminator of detailed fiscal data for Sri Lanka, although the MoF has expanded its dissemination of analytical fiscal data. The CBSL has introduced a number of enhancements to statistics, including the provision of more detailed estimates and the implementation in 2004 of an advance release calendar, aimed at bolstering public information flows.³⁷ The release of CBSL data is also now accompanied by a media release and/or press conference explaining any revisions.

3. OPEN BUDGET PREPARATION, EXECUTION, AND REPORTING



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Fiscal policy objectives, macroeconomic framework, and risks

Every September the CBSL presents a state of the economy report to the MoF in order for the latter to prepare the budget for the following year, which is usually presented to parliament in November.

Fiscal policy objectives

The budget speech specifies broad fiscal objectives, together with a statement of priorities of major government programmes. Fiscal policy objectives focus mainly on the central government. An underlying medium-term framework, as envisaged under the FMRA and the *Fiscal Strategy Statement*, guides the macroeconomic assumptions and overall preparation of the budget.

Overall, the FMRA provides for a far more open and accountable budgetary system. Under its framework, the MoF is required to give budget projections; fiscal policy was rarely openly disclosed before this law came into force. However, commentators say that the new government has not respected most of the limits and targets enshrined in the FMRA, particularly regarding fiscal deficit levels.³⁸ The cost of the tsunami and the recent presidential elections have also diverted focus away from proper implementation of this law.³⁹ The IMF has also stated that the act still does not address its envisaged changes in the legal framework for the management of public finances.⁴⁰

Macroeconomic framework

The previously published *Budget Estimates* is unavailable this year. Only the budget speech and the *Budget Economic and Fiscal Position Report 2006* report have been published. The latter includes a medium-term macroeconomic framework and fiscal strategy document for 2006-08 for expenditure estimates as far as 2009. The policy objectives are broadly defined as to stimulate economic growth, increase employment opportunities and earning capacity, and to ensure consistent economic development over the medium term. There is also a series of policy measures to improve revenue performance and a clear division between tsunami and non-tsunami expenditure and investment.⁴¹ However, the IMF has noted that there has been considerably less information provided in the 2005 budget and the recently released 2006 budget is similar.⁴²

This year the government violated basic principles of good governance by preparing and presenting its budget immediately prior to the presidential elections. The 2006 Budget was presented on 8 November - just nine days before the presidential elections - and included enticing tax breaks for the country's many rural farmers. The budget also normally requires three weeks of continuous debate, something which was impossible so close to elections. Consequently, the budget has been overshadowed by the onset of the elections. Furthermore, commentators say that according to the FMRA the government must reveal fiscal implications of any election promises -- something which neither of the presidential candidates did. The newly elected president annulled the 2006 Budget and released a second budget on 8 December 2005; this too violates FMRA stipulations.⁴³

Fiscal risks

The 2005 budget documents identified areas of fiscal challenge, notably the fragile state of public finances and growing public debt. Significantly, the FMRA stipulates that the minister of finance must provide a statement on contingent liabilities (including guarantees and indemnities), expenditure not outlined in the budget, and any ongoing negotiations that may be relevant and could become a source of liabilities. Overall, fiscal transparency would benefit from including a more comprehensive assessment of the major fiscal risks in budget documentation. The Fiscal Strategy Statement at present only contains a brief assessment of risks to the budget.⁴⁴

Commentators also highlighted that both the 2005 and 2006 budget rely on increased expenditure, focusing on rising wage levels for the public sector, subsidies and instituting new tax exemptions. These increases in spending are financed mainly through tax increases. The saving arising from the G7 debt moratorium has been spent mostly on increased fuel subsidies. This spending has seen the budget deficit widen to an estimated 8.5% in the last year, and the 2006 budget will increase it by a further 0.5%. However, no statement outlining these effects is included in the budget speech. The size of the budget deficit also violates the FMRA, which states that the budget deficit should be reduced to 5% of GDP by 2006 – a target now clearly unattainable. Commentators have mixed reactions; some see it as the government's failure to be prudent, others are more lenient pointing out such external shocks as the tsunami and the oil price rise as significant factors.⁴⁵

Fiscal sustainability

The cessation of hostilities in the country's internal conflict boosted the government's ability to meet its fiscal targets, although defence expenditure in the 2006 Budget has increased in real terms. However, with permanent peace still some way off, the risk of renewed high military spending remains real and there is now the added burden of rebuilding communities and livelihoods following the tsunami. A general exercise on the medium-term fiscal position is included in the *Budget Economic and Fiscal Position Report* (which is part of the *Fiscal Strategy Statement*), submitted along with the budget speech by the government in agreement with FMRA terms. The report is available online.⁴⁶

Budget presentation

Data reporting

The budget speech and documents identify the principal policy initiatives that the government intends to adopt during the coming fiscal year and in the medium term, but fail to provide comprehensive detail. However, the FMRA provides a clearer framework, including comprehensive fiscal data, which allows for greater analysis and accountability.

The FMRA obliges the government to report to parliament on the progress that has been made by each ministry in implementing economic reforms. Under the law, budgets for the respective line ministries are directly linked to progress made in implementing reform.

For the introduction of the *Performance Budgeting System*, a number of project objectives and performance indicators for the period 2005-07 (for each project) are included in the 2005 budget documentation. These objectives and performance indicators are designed to identify specific results that will be accomplished with the allocated expenditures, and the results projected for 2006-07 with the intended budget allocations for those years.

Budget execution and monitoring

Information that compares the budgeted figures with the outturns of the preceding fiscal year, and the forecasts of the main budget aggregates for the following fiscal year, are included in the budget speech. Appropriations are also compared with the outturns of budgetary execution.

Accounting basis

Some concerns continue to be expressed about the current system of cash accounting, which makes it difficult to track payment arrears. The IMF has recommended that Sri Lanka move to an accrual accounting system, but although some training took place in 2003, there has been no progress in this area since the arrival of the new government.⁴⁷ Further concerns are also raised about large deviations and overruns from budget figures in previous years.⁴⁸ Overall, Sri Lanka's accounting standards are a reasonable proxy to International Accounting Standards. The MoF subscribes to the International Public Sector Accounting Standards (IPSAS).

Procurement and employment

It is unclear whether regulations governing procurement and employment are effectively standardised. Several high-level government committees, including COPE and COPA, exist to oversee and investigate malpractice within the public sector, but it is hard to assess how effective these bodies are and Sri Lanka's private sector has called for greater transparency in this area.⁴⁹ There are some concerns that the cabinet-appointed tender boards are a source of malpractice/graft.⁵⁰ There are proposals for legislation to streamline the procurement process, and a new National Procurement Agency was set up in 2004 to oversee standards of public procurement and take over from the Ministry of Finance, which previously carried out this task.⁵¹

Public sector administrative reform has thus far been slow. The government has pledged to increase public sector wage levels by 40%, and is using recruitment into the public sector as one means of reducing graduate unemployment. This lack of expenditure restraint runs the risk of rendering the Sri Lankan government's fiscal position unsustainable over the medium term.

Fiscal reporting

The CBSL disseminates fiscal data on a monthly basis, although there is a time lag in the release of the data of two, sometimes three, months. This includes data on central government aggregates on revenue, expenditure, taxes on income and various categories of non-tax revenue. This monthly release of data comes close to meeting SDDS terms for coverage, periodicity and timeliness.

Section 10 of the FMRA requires that a Mid-Year Fiscal Position Report in respect of the fiscal performance during the first four months of the year be released to the public by the last day of June and thereafter laid before parliament. In this mid-year review, the finance minister is obliged to report to parliament any deviation from the original public spending or revenue targets set out in the national budget. The reason for the deviation must be explained, together with the action to be taken to rectify it. The Mid-Year Fiscal Position Report of 2005 was presented in a timely fashion; the report is available online on the MoF website.

Under the FMRA, the minister of finance is required to report three times each year to parliament on the government's budgetary management. Although the minister has actually only reported twice this year (in the Mid-Year Fiscal Position Report and with the Budget), commentators have said they do not think it necessary to report three times.⁵²

A cause for concern in 2005 has been the spending of tsunami aid. So far, Sri Lanka has had such limited capacity, it has only managed to utilise around 15% of pledged aid. Allegedly, much of this funding has gone to corrupt recipients. In addition, a substantial part of aid is off-budget, under the coordination of a specially created agency: the *Task Force for Rebuilding the Nation*.⁵³

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY



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Data quality standards

The new FMRA has improved fiscal transparency, data quality and monitoring. However, the act also has a clause that permits departure from the stipulations of the legislation with the approval of parliament. As such, when the act was passed, there were concerns as to how effectively the legislation will hold future governments to account. Commentators have since stated that although the present government seems uncommitted to achieving the goals set out in FMRA, there is now better information available on the fiscal position.⁵⁴

The main method to check data quality in consolidated central government accounts is to reconcile figures with appropriate CBSL data. Concerns about the methodology used to compile data for central government budgetary aggregates remain, partly because details of the relevant methodologies are difficult to obtain.⁵⁵

Independent scrutiny of fiscal information

Independent Audit

The Auditor General's Department (AGD) is the highest auditing authority, with jurisdiction over central and sub-national governments, and other public bodies. The Auditor General applies standard procedures in auditing all government ministries and departments, and can also appoint other external auditors to help carry out audits. There has been some concern that the reports of the Auditor General should be published in a more timely fashion.⁵⁶ Such delays have typically been the result of a lack of resources assigned to the AGD. In practice, this lack of funds has also meant that the AGD is unable to retain well-qualified staff.

There is no evidence of government interference in the work of the AGD, but this may be the result of the fundamental weakness of its powers. Indeed, the AGD has been perceived as being ineffective.⁵⁷ For example, it does not have independent sources of funding -- it depends on Treasury allocation, which could potentially be subject to political manipulation. Moreover, the Auditor General's powers are restricted to the supervision of ministries, public corporations, and other government institutions; private enterprises in which the state has equity shares are out of the AGD's remit. The audit reports are not made public -- they are available only to COPE and COPA. In 2004, the Dutch Court of Audit conducted a peer review of the AGD, making several recommendations for the improvement of its functions.⁵⁸ A new audit act was passed on October 17, 2005 making the Auditor General's Department independent of the government. This act satisfies the majority of recommendations made by Transparency International and others.

National Statistics Agency

Sri Lanka's Department of Census and Statistics provides a range of demographic and socio-economic statistics, as well as verifying fiscal data. It releases estimates on national economy accounts annually to the public in its *National Accounts of Sri Lanka* publication. These can be purchased, or retrieved online.⁵⁹ The Department functions under two ordinances, the Census Ordinance and the Statistics Ordinance, which provide for the integrity and quality of its data.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Sri Lanka between 24 and 27 October 2005.

Ministry of Finance

Despite considerable effort to meet with someone from the Ministry of Finance in Sri Lanka, Oxford Analytica was not granted an interview.

Central Bank of Sri Lanka

25 October 2005

H. N. Thenuwara	Director	Economic Research Department
B. D. W. A. De Silva	Deputy Director	Economic Research Department

ADDITIONAL INTERVIEWS

26 October 2005

Luis Valdivieso	Senior Resident Representative	International Monetary Fund
Princess Ventura	Economist	World Bank, Colombo
Sriyani Hulugalle	Senior Industrial Economist	World Bank, Colombo

24 October 2005

J.C. Weliamuna	Executive Director	Transparency International Sri Lanka Chapter
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NOTES

- ¹ See the 1978 Constitution of Sri Lanka at: www.priu.gov.lk/Cons/1978Constitution/Introduction.htm
- ² See 'Tamil autonomy fears spark emergency rule', *Oxford Analytica Daily Brief*, 6 November 2003.
- ³ Interviews in Sri Lanka, 15-18 November 2004.
- ⁴ See *New Policy Initiatives*, Dr Saranth Amunugama, (Minister of Finance and Planning), Budget Speech, November 18 2004, www.treasury.gov.lk/docs/Bud%20Speech%202005%20part%20%20A.pdf
- ⁵ Interviews in Sri Lanka, 24-27 October 2005.
- ⁶ Interviews in Sri Lanka, 15-18 November 2004.
- ⁷ Interviews in Sri Lanka, 24-27 October 2005.
- ⁸ 'IMF Sri Lanka Report on the Observance of Standards and Codes Fiscal Transparency Module: An update' 13 July 2005: Page 2, Point 5. See <http://www.imf.org/external/pubs/ft/scr/2005/cr05251.pdf>
- ⁹ Interviews in Sri Lanka, 24-27 October 2005.
- ¹⁰ 'IMF Sri Lanka Report on the Observance of Standards and Codes Fiscal Transparency Module: An update' 13 July 2005: Page 2, Point 5. See <http://www.imf.org/external/pubs/ft/scr/2005/cr05251.pdf>
- ¹¹ See, for example, *Sri Lanka: 2002 Article IV Consultation and Final Review Under the Stand-by Arrangement-Staff Report*, IMF Country Report No. 02/199, September 2002, Box 1, p.12
- ¹² Interviews in Sri Lanka, 15-18 November 2004.
- ¹³ Interviews in Sri Lanka, 15-18 November 2004. The EPF has been removed from CBSL control but is still under government supervision.
- ¹⁴ Interviews in Sri Lanka, 15-18 November 2004 and 24-27 October 2005.
- ¹⁵ Interviews in Sri Lanka, 24-27 October 2005.
- ¹⁶ Interviews in Sri Lanka, 15-18 November 2004 and 24-27 October 2005. Under the FMRA, the budget deficit needs to be reduced to 5% of GDP by the end of 2006 (this has been pushed back to 2008) and total government debt reduced to 85% of GDP by 2006 (this has also been pushed back to 2008), and then 60% of GDP by 2013.
- ¹⁷ See *Fiscal Strategy Statement 2006* at:
<http://www.fpd.gov.lk/pdf/Budget%202006/Fiscal%20Strategy%20Statement%20English%20%202006.pdf>
- ¹⁸ Interviews in Sri Lanka, 15-18 November 2004.
- ¹⁹ 'IMF Sri Lanka Report on the Observance of Standards and Codes Fiscal Transparency Module: An update' 13 July 2005: Page 2, Point 8. See <http://www.imf.org/external/pubs/ft/scr/2005/cr05251.pdf>
- ²⁰ See 'Sri Lanka: 2003 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion', IMF Country Report 04/68, March 2004, at:
www.imf.org/external/pubs/ft/scr/2004/cr0468.pdf
- ²¹ Interviews in Sri Lanka, 24-27 October 2005.
- ²² Budget 2006 at www.fpd.gov.lk, Section 71
- ²³ *Strategies for Growth Leveraging the Private Sector*, Ceylon Chamber of Commerce, at: www.chamber.lk
- ²⁴ Ministry of Finance and Planning -- Treasury Secretariat at: www.treasury.gov.lk
- ²⁵ Interviews in Sri Lanka, 24-27 October 2005.
- ²⁶ 'IMF Sri Lanka Report on the Observance of Standards and Codes Fiscal Transparency Module: An update' 13 July 2005: Page 5, Point 22. See <http://www.imf.org/external/pubs/ft/scr/2005/cr05251.pdf>
- ²⁷ See www.fpd.gov.lk/publication1.htm
- ²⁸ Interviews in Sri Lanka, 15-18 November 2004.
- ²⁹ Interviews in Sri Lanka, 15-18 November 2004.
- ³⁰ *Strategies for Growth Leveraging the Private Sector*, Ceylon Chamber of Commerce, at: www.chamber.lk
- ³¹ Interviews in Sri Lanka, 15-18 November 2004.
- ³² Interviews in Sri Lanka, 24-27 October 2005.
- ³³ Interviews in Sri Lanka, 24-27 October 2005.
- ³⁴ Interviews in Sri Lanka, 24-27 October 2005.
- ³⁵ Interviews in Sri Lanka, 15-18 November 2004.
- ³⁶ Interviews in Sri Lanka, 15-18 November 2004.
- ³⁷ Interviews in Sri Lanka, 15-18 November 2004.
- ³⁸ Interviews in Sri Lanka, 15-18 November 2004. The 2005 budget presented in November 2004 instituted a wide-ranging programme of subsidies and wage increases.
- ³⁹ Interviews in Sri Lanka, 24-27 October 2005.

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- ⁴⁰ 'IMF Sri Lanka Report on the Observance of Standards and Codes Fiscal Transparency Module: An update' 13 July 2005: Page 2, Point 4. See <http://www.imf.org/external/pubs/ft/scr/2005/cr05251.pdf>
- ⁴¹ See *Fiscal Strategy Statement and Budget Economic and Fiscal Position Report 2006* at: <http://www.fpd.gov.lk/pdf/Budget%202006/Fiscal%20Strategy%20Statement%20English%20%202006.pdf>
- ⁴² 'IMF Sri Lanka Report on the Observance of Standards and Codes Fiscal Transparency Module: An update' 13 July 2005: Page 5, Point 21. See <http://www.imf.org/external/pubs/ft/scr/2005/cr05251.pdf>
- ⁴³ Interviews in Sri Lanka, 24-27 October 2005 and Budget Speech 2006 at <http://www.treasury.gov.lk/FPPFM/fpd/pdfdocs/budget2006dec/budget2006english.pdf>.
- ⁴⁴ 'IMF Sri Lanka Report on the Observance of Standards and Codes Fiscal Transparency Module: An update' 13 July 2005: Page 4, Point 15. See <http://www.imf.org/external/pubs/ft/scr/2005/cr05251.pdf>
See *Fiscal Strategy Statement and Budget Economic and Fiscal Position Report 2006* at: <http://www.fpd.gov.lk/pdf/Budget%202006/Fiscal%20Strategy%20Statement%20English%20%202006.pdf>
- ⁴⁵ Interviews in Sri Lanka, 15-18 November 2004 and 24-27 October 2005. At present, total government revenue is only sufficient for paying the salaries of public sector employees and interest payments on public debt. However, in the 2005 budget the government pledged a one percent reduction in the fiscal deficit for 2005. Rather than shrink, the fiscal deficit has in fact widened, and is also forecast to rise in the coming year.
- ⁴⁶ See *Fiscal Strategy Statement and Budget Economic and Fiscal Position Report 2006* at: <http://www.fpd.gov.lk/pdf/Budget%202006/Fiscal%20Strategy%20Statement%20English%20%202006.pdf>
- ⁴⁷ Interviews in Sri Lanka, 24-27 October 2005.
- ⁴⁸ See 'Sri Lanka: 2003 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion', IMF Country Report 04/68, March 2004 at: www.imf.org/external/pubs/ft/scr/2004/cr0468.pdf
- ⁴⁹ *Strategies for Growth Leveraging the Private Sector*, Ceylon Chamber of Commerce, at: www.chamber.lk
- ⁵⁰ Interviews in Sri Lanka, 13-18 November 2003. The cabinet has the power to bypass normal proceedings when it chooses and award contracts to whomever it wishes.
- ⁵¹ 'IMF Sri Lanka Report on the Observance of Standards and Codes Fiscal Transparency Module: An update' 13 July 2005: Page 4, Point 18. See <http://www.imf.org/external/pubs/ft/scr/2005/cr05251.pdf>
- ⁵² Interviews in Sri Lanka, 24-27 October 2005. Mid-Year Fiscal Position Report 2005 is at <http://www.fpd.gov.lk/FMRA.htm>
- ⁵³ Interviews in Sri Lanka, 24-27 October 2005.
- ⁵⁴ For example, the government published the fulfilment of the provisions of the 2005 budget in a state-owned newspaper in November 2005.
- ⁵⁵ Interviews in Sri Lanka, 13-18 November 2003.
- ⁵⁶ *Sri Lanka: 2002 Article IV Consultation and Final Review Under the Stand-by Arrangement- Staff Report*, IMF Country Report No. 02/199, September 2002, Box 1, p.12.
- ⁵⁷ Interviews in Sri Lanka, 15-18 November 2004.
- ⁵⁸ Interviews in Sri Lanka, 15-18 November 2004.
- ⁵⁹ See *National Accounts of Sri Lanka* at: www.statistics.gov.lk/national_accounts/index.htm